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In the Supreme Court of the United States

OCTOBER TERM, 1936

No. 398

FOUNDERS GENERAL CORPORATION, PETITIONER

v.

JAMES J. HOEY, COLLECTOR OF UNITED STATES INTERNAL REVENUE FOR THE SECOND DISTRICT OF THE STATE OF NEW YORK

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the District Court (R. 27–34) is reported in 12 F. Supp. 290. The opinion of the Circuit Court of Appeals (R. 45–50) is reported in 84 F. (2d) 976.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 13, 1936 (R. 51). The petition for a writ of certiorari was filed September 25, 1936,

and was granted November 9, 1936. The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Petitioner subscribed for original shares and accompanying warrants in A corporation. The certificate therefor was then issued by A, pursuant to petitioner's direction, in the name of B, who had agreed to hold them as petitioner's nominee. Did this transaction involve a taxable transfer within the meaning of Section 800, Schedule A–3 of the Revenue Act of 1926?

STATUTES AND REGULATIONS INVOLVED

These are set forth in the Appendix, *infra,* pp. 12–16.

STATEMENT

This action was brought by petitioner on November 28, 1934, for the recovery of $4,733.33 paid as documentary stamp taxes (R. 2–24). Respondent moved to dismiss the complaint and for judgment on the ground of failure to allege facts sufficient to state a cause of action (R. 25–26). The District Court sustained the motion and entered judgment for respondent and against petitioner on September 28, 1935 (R. 34–37). The Circuit Court of Appeals affirmed the judgment (R. 50).

The facts, as set forth in petitioner's complaint (R. 3–24), may be summarized as follows:

On September 10, 1929, petitioner entered into a written contract with the United States Electric Power Corporation, a Maryland corporation, whereby petitioner subscribed for 100,000 shares of the original issue of stock of the Power Corporation at $13.50 per share. Each share was to be accompanied by a warrant entitling the holder to subscribe for one additional share at $25 before January 2, 1940. (R. 3–4.)

The closing of the transaction by delivery of stock certificates with warrants attached, and payment therefor, was set for September 17, 1929. (R. 4.)

Subsequent to the subscription, but prior to the time fixed for closing the transaction, petitioner directed the Power Corporation to issue a single certificate for the stock in the name of Benton & Company, a co-partnership, petitioner's nominee. (R. 4.) These instructions were followed and the certificate was issued in the name of Benton & Company but delivered to petitioner, who paid the agreed subscription price. (R. 5–6.) Under a written contract executed in March, 1928 (R. 13–19) the petitioner was authorized, as agent and attorney for Benton & Company, to endorse the latter's name in effecting further transfers. (R. 16.) The sole business of Benton & Company was to take and hold in its name securities for the account of petitioner. (R. 9–10.) For acting as its nominee, petitioner paid Benton & Company an annual compensation of $1,500. (R. 14.)

The original issue tax on the shares was paid as required under Schedule A–2, Title VIII of the Revenue Act of 1926, and is not in dispute. In addition thereto, there was assessed in October, 1934, a transfer tax against petitioner in the sum of $4,733.33, under Schedule A–3 of the Act, in respect of the foregoing transaction upon the transfer by petitioner of "legal title to said stock or of the right to receive the same" (R. 6–7).

The assessment was paid and, on October 26, 1934, petitioner filed its claim for refund which was rejected on November 20, 1934 (R. 6–7).

SUMMARY OF ARGUMENT

Petitioner became a stockholder in the issuing corporation by virtue of its stock subscription. As a stockholder petitioner had the legal title to the shares. If petitioner did not become a stockholder until payment of the subscription price, at all events it had the sole right to receive the shares and certificate. Petitioner effectively transferred to its nominee its title or right to receive, by virtue of the direction that the stock certificate be issued in the name of the nominee and the compliance with that direction. The fact that the certificate was delivered to petitioner does not negative this conclusion. Such delivery was made pursuant to a power of attorney granted to petitioner as agent of its nominee. This arrangement only serves to confirm the fact that rights were transferred to the nominee.

Under the New York stock transfer tax statute, it has been held that the issuance of a stock certificate in the name of an accommodation endorser at the direction of the beneficial owner constitutes a transfer of the legal title to the shares. *Travis* v. *Ann Arbor* Co., 180 App. Div. 799, affirmed, 227 N. Y. 640.

As is pointed out in the Government's brief in *United States* v. *A. B. Leach & Co., Inc.*, No. 331, present term, the argument of taxpayer is an attempt to read into the statute an exemption which Congress has not seen fit to make. Amendments to the 1926 Act have exempted a limited class of nominee transactions, involving nominees of fiduciaries and brokers. The failure of Congress to enlarge these exemptions indicates that a transaction of the type here involved is intended to come within the general provisions of the Act.

ARGUMENT

Petitioner, by subscribing on September 10, 1929 for original shares of the United States Electric Power Corporation, became a stockholder of that corporation. It is generally held, in the absence of statutory or contractual provisions to the contrary, that a subscriber to an original issue of stock becomes a shareholder upon acceptance of the subscription, even though the price has not been paid or certificates delivered. *Reagan* v. *Midland Packing Co.*, 298 Fed. 500 (N. D. Iowa), affirmed with-

out passing on this point, 8 F. (2d) 954 (C. C. A. 8th); *Wheeler* v. *Millan*, 99 N. Y. 353; Morawetz, *Private Corporations* (2d Ed.), Sec. 56. Some courts have drawn a distinction in this regard between shares in a newly formed corporation and shares in an existing corporation, *cf. Baltimore City Ry. Co.* v. *Hambleton*, 77 Md. 341, 346, but the distinction is of no moment here, for the subscription was for shares in a corporation then being organized.[2] The stamp-tax regulations likewise recognize that stock may be issued by virtue of a stock subscription. Article 77 (b) of Treasury Regulations 71, relating to stamp taxes imposed by Title VIII of the Revenue Acts of 1926 and 1928, provides: "The term 'issue' includes not only actual delivery of, but also acceptance of subscriptions to shares or certificates of stock * * *."

As a stockholder on September 10, 1929, petitioner had the sole right to receive the stock certificates, and the right to transfer legal title to the stock, to the certificates, and to the right to receive the certificates. The subsequent direction by petitioner that the certificate be issued in the name of Benton & Company, and the compliance with that direction, necessarily involved a transfer by

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[2] The certificate evidencing the shares is described in the bill of complaint as "a certificate of original issue" (R. 5). Reference to Moody's Manual of Public Utilities discloses the fact that the United States Electric Power Corporation was incorporated under the laws of Maryland on September 10, 1929, the date of petitioner's subscription.

petitioner of its shares and the right to receive the certificate therefor.

Even if petitioner did not become a stockholder upon entering into the subscription agreement, it had at that time the right to become a stockholder and to receive the shares and certificate therefor upon payment of the subscription price. These rights were transferred within the meaning of the Act. As the Circuit Court of Appeals pointed out, it is not requisite that the rights transferred be unconditional at the time of transfer (R. 18).

It is true that the certificate was delivered to petitioner, and not to Benton & Company, its nominee. But such delivery does not negative the fact that Benton & Company had been given legal title and the right to receive the shares and certificates by virtue of the issuance thereof in its name. The delivery to petitioner was made pursuant to an agreement between it and its nominee. Petitioner received the certificate as agent of Benton & Company. The collateral agreement between petitioner and its nominee could not affect the rights possessed by the latter with respect to third parties. The certificate was unavailable for transfer until endorsed by Benton & Company or by petitioner as agent of the latter under the power of attorney contained in their agreement. The use of a nominee was admittedly for the purpose of facilitating transfers of title to third parties. If the nominee did not possess title or the right to receive the shares and certificate, it is difficult to

see how it could, in turn, transfer these to others. The entire arrangement fortifies, instead of weakening, the conclusion that there was a transfer by petitioner to its nominee.

Petitioner contends (brief in support of petition, p. 20) that there was no transfer "of anything" by petitioner because as subscriber it had the right to have the certificates issued either in its name or in that of another, and therefore there was but one transaction. But a similar argument could have been made in *Raybestos-Manhattan Co.* v. *United States,* 296 U. S. 60. There, the old corporation had the right, upon conveyance of its assets, to receive the new shares or to direct their issuance in the name of its stockholders. The latter course involved a taxable transfer.

Travis v. *Ann Arbor Co.,* 180 App. Div. 799, affirmed, 227 N. Y. 640, cited by the Circuit Court of Appeals, supports the decision in the instant case. There, the defendant corporation was the owner of certain shares for which the stock certificate had been issued in the name of an individual. Subsequently the defendant directed that the certificate be canceled and a new certificate issued in the name of another. This was done, and the defendant's nominee endorsed the new certificate in blank and left it with the transfer agent of the stock, where it remained subject to the order of the defendant. There was no change in the defendant's beneficial ownership of the stock from the

time of its original purchase. Upon these facts the court held that two transfer taxes were payable, one with respect to the issuance of the new certificate in the name of defendant's nominee, and one in respect of the nominee's endorsement in blank. The statute under which these taxes were imposed was less broad than the Federal Act, for it taxed transfers of legal title to shares or certificates, but not legal title to the right to receive them. The Appellate Division of the New York Supreme Court said (p. 801):

> When the defendant caused the certificate of stock owned by it to be canceled and a new certificate of stock to be issued in the name of Harrison, it thereby caused the legal title to the stock to be transferred to him; and when Harrison indorsed the certificate of stock in blank, and left it with the trust company for the defendant, he transferred the legal title to the stock to whomsoever might be the holder thereof. Hence there accrued two taxable transfers. The application of any other rule would be opposed to the plain wording of the statute, and furnish in many cases an easy method of evasion of the tax.

It is to be noted that in the *Ann Arbor* case, as here, the transferee did not receive delivery of the certificate and had no beneficial interest in the shares. The mere fact that the stock certificate was issued in his name pursuant to the direction of the bene-

ficial owner constituted a taxable transfer of legal title by the owner to its nominee. The endorsement by the nominee in blank as part of the arrangement, so far from negativing a transfer of title to the nominee, constituted a separate transfer. In the present case, as the court below pointed out, it is only necessary to show that the nominee was given the right to receive the shares or the certificate.

The present case closely resembles *United States* v. *A. B. Leach & Co., Inc.*, pending on writ of certiorari, No. 331. The arguments advanced in the Government's brief in that case concerning the scope of the taxing Act are applicable here. We have there shown that the existence of a beneficial interest in the transferee is not a requisite under the statute. We have also shown that the course of amendment to the 1926 Act, notably in 1932 and 1936, points to the conclusion that nominee transactions of the present type are intended to be covered by the general provisions of the Act. Those amendments exempted nominee transactions in limited classes of cases involving fiduciaries and brokers. The arguments on these points in the Government's brief in the *Leach* case will not be repeated here, but reference thereto is respectfully made.

CONCLUSION

For the foregoing reasons, the judgment of the Circuit Court of Appeals should be affirmed.

Respectfully submitted.

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JANUARY 1937.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9, 99, 101:

TITLE VIII.—STAMP TAXES

SEC. 800. On and after the expiration of thirty days after the enactment of this Act there shall be levied, collected, and paid, for and in respect of the several bonds, debentures, or certificates of stock and of indebtedness, and other documents, instruments, matters, and things mentioned and described in Schedule A of this title * * *. (U. S. C., Title 26, Sec. 900.)

SCHEDULE A—STAMP TAXES

* * * * *

2. Capital stock, issue: On each original issue, whether on organization or reorganization, of certificates of stock, or of profits, or of interest in property or accumulations, by any corporation, on each $100 of face value or fraction thereof, 5 cents: *Provided,* That where a certificate is issued without face value, the tax shall be 5 cents per share, unless the actual value is in excess of $100 per share, in which case the tax shall be 5 cents on each $100 of actual value or fraction thereof, or unless the actual value is less than $100 per share, in which case the tax shall be 1 cent on each $20 of actual value, or fraction thereof.

The stamps representing the tax imposed by this subdivision shall be attached to the stock books and not to the certificates issued.

3. Capital stock, sales or transfers: On all sales, or agreements to sell, or memoranda of sales or deliveries of, or transfers of legal title to shares or certificates of stock or of profits or of interest in property or accumulations in any corporation, or to rights to subscribe for or to receive such shares or certificates, whether made upon or shown by the books of the corporation, or by any assignment in blank, or by any delivery, or by any paper or agreement or memorandum or other evidence of transfer or sale, whether entitling the holder in any manner to the benefit of such stock, interest, or rights, or not, on each $100 of face value or fraction thereof, 2 cents, and where such shares are without par or face value, the tax shall be 2 cents on the transfer or sale or agreement to sell on each share: *Provided*, That it is not intended by this title to impose a tax upon an agreement evidencing a deposit of certificates as collateral security for money loaned thereon, which certificates are not actually sold, nor upon the delivery or transfer for such purpose of certificates so deposited, nor upon mere loans of stock nor upon the return of stock so loaned: *Provided further*, That the tax shall not be imposed upon deliveries or transfers to a broker for sale, nor upon deliveries or transfers by a broker to a customer for whom and upon whose order he has purchased same, but such deliveries or transfers shall be accompanied by a certificate setting forth the facts: *Provided further*, That in case of sale where the evidence of transfer is shown only by the books of the corporation the stamp shall be placed upon such books; and

where the change of ownership is by transfer of the certificate the stamp shall be placed upon the certificate; and in cases of an agreement to sell or where the transfer is by delivery of the certificate assigned in blank there shall be made and delivered by the seller to the buyer a bill or memorandum of such sale, to which the stamp shall be affixed; and every bill or memorandum of sale or agreement to sell before mentioned shall show the date thereof, the name of the seller, the amount of the sale, and the matter or thing to which it refers. Any person liable to pay the tax as herein provided, or anyone who acts in the matter as agent or broker for such person, who makes any such sale, or who in pursuance of any such sale delivers any certificate or evidence of the sale of any stock, interest or right, or bill or memorandum thereof, as herein required, without having the proper stamps affixed thereto, with intent to evade the foregoing provisions, shall be deemed guilty of a misdemeanor, and upon conviction thereof shall pay a fine of not exceeding $1,000, or be imprisoned not more than six months, or both. (U. S. C., Title 26, Sec. 902.)

Treasury Regulations 71, approved July 7, 1928, promulgated under the Revenue Act of 1926:

ART. 31. *Basis of tax.*—Every transfer or sale of stock, either before or after issuance of a certificate, is taxable. The tax accrues at time of making the sale or agreement to sell or memorandum of sale, or delivery of, or transfer of the legal title to shares, or certificates of stock, or of profits, or of interest in property or accumulations in any cor-

poration, joint stock company, or association, or of the right to subscribe for or to receive such shares or certificates, regardless of the time or manner of the delivery of the certificate or agreement or memorandum of sale.

ART. 34. *Sales and transfers subject to tax.* The following transactions are subject to the tax:

(a) The sale, or transfer, or change of ownership, of certificates of stock, or of profits, or of interest in property or accumulations in corporations, joint-stock companies, or associations.

(b) The sale or transfer of shares of stock, whether or not represented by certificates.

(c) The transfer of stock to or by trustees.

* * * * *

(g) The transfer of the interest of a subscriber for stock, however such interest may be evidenced or conditioned upon further payments.

(h) The transfer of the right to subscribe for stock in any corporation, joint-stock company, or association, whether or not evidenced by warrants.

* * * * *

(t) The transfer of the right to receive stock which a corporation has unconditionally agreed to issue.

(u) Transfers of stock are subject to the tax even though the holders thereof are not entitled in any manner to the benefit of the stock.

ART. 77. *Further definitions.*—(1) When used in these regulations:

* * * * *

(b) The term "issue" includes not only actual delivery of, but also acceptance of subscriptions to shares or certificates of stock, or of profits or of interest in property or accumulations in any corporation, joint-stock company, or association.

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